Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Garrick	Analyst:	Angela Raygoza	Bill Number:	AB 327
Related Bills:	See Legislative History	Telephone:	845-7814	Introduced Date:	February 18, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Minimum Franchise Tax/Change from $800 to $100

SUMMARY

This bill would reduce the Minimum Franchise Tax (MFT) from $800 to $100.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to: 1) encourage small businesses to comply with laws governing businesses, 2) make California more competitive with other states for business, and 3) reduce governmental costs for businesses so they may reinvest in their business.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2009.

POSITION

Pending.

ANALYSIS

STATE LAW

Under existing state law, unless specifically exempted by statute, every corporation organized or qualified to do business or that is doing business in this state, whether organized in state or out-of-state, is subject to the MFT. Taxpayers must pay the MFT only if it is more than their measured franchise tax. For taxable years beginning on or after January 1, 1997, only taxpayers with net income less than approximately $9,040 pay the MFT because the amount of measured tax owed would be less than $800 ($9,039 x 8.84% = $799).

Real estate mortgage investment conduits (REMICs) are subject to and required to pay the MFT. Regulated investment companies (RICs) and real estate investment trusts (REITs) organized as corporations are also subject to and required to pay the MFT.

Board Position:			Department Director	Date
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The tax on limited partnerships (LPs), limited liability companies (LLCs) not classified as corporations, limited liability partnerships (LLPs), and qualified Subchapter S subsidiaries (QSSSs) is set at $800 by reference to the MFT.

Every corporation that incorporates or qualifies to do business in this state is exempt from the MFT for the first taxable year of existence. This exemption is inapplicable to any corporation that reorganizes solely for the purpose of avoiding payment of the MFT. In addition, the exemption does not apply to LPs, LLCs not classified as corporations, LLPs, charitable organizations, RICs, REITs, REMICs, financial asset securitization investment trusts, and QSSSs.

THIS BILL

This bill would reduce the MFT from $800 to $100 for taxable years beginning on or after January 1, 2009, excluding corporations that are exempt from paying the MFT during the first taxable year. By reference to the MFT, the annual tax for the LPs, LLCs not classified as corporations, LLPs, and QSSSs would also be reduced to $100. .

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

TECHNICAL CONSIDERATIONS

Amendments 1 has been provided as a technical amendment to remove out dated language.

LEGISLATIVE HISTORY

AB 1179 (Garrick, 2007/2008) and AB 1419 (Campbell, 1997/1998) would have reduced the MFT from $800 to $100. AB 1179 failed passage out of the Assembly Revenue and Taxation Committee. AB 1419 failed passage out of the Senate Revenue and Taxation Committee.

AB 2178 (Garrick, 2007/2008) would have reduced the MFT from $800 to $200. AB 2178 failed passage out of the Assembly Revenue and Taxation Committee.

PROGRAM BACKGROUND

The MFT was established to ensure that all corporations pay at least a minimum amount of franchise tax for the privilege of doing business in this state, regardless of the corporation’s income or loss.

OTHER STATES’ INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida has a corporate income tax of 5.5% with no minimum tax.

Illinois has an annual franchise tax of 1% of the tax base. The tax base is calculated by using the shares of stock issued by the corporation as disclosed in the annual statement reported to the Illinois Secretary of State. The tax ranges from a minimum of $25 to a maximum of $1 million.

Massachusetts imposes the greater of a corporate excise tax of 9.5% based on taxable income or a minimum tax equal to $456. In lieu of the corporate excise tax, the corporate franchise tax is imposed on cemetery companies, crematory companies, canal companies, and safe deposit companies.

Michigan replaced the Single Business Tax with the Michigan Business Tax (MBT) that includes a business income tax and a gross receipts tax, for taxable years beginning on or after January 1, 2008. *Michigan* does not have a minimum tax. All persons engaged in a "business activity" and that have “gross receipts” in Michigan are subject to the MBT. The business income tax is 4.95% and the gross receipts tax is .080%.

Minnesota has a franchise tax that is imposed on a corporation’s taxable income at the rate of 9.8%. An additional franchise tax is imposed, ranging from $0 to $5,000, based on the sum of the property determined by property, payroll, and sales in the state.

New York imposes a franchise tax of 7.01% based on net income plus a fixed dollar minimum tax based on gross payroll. The fixed dollar minimum tax ranges from $100 to $1,500.

FISCAL IMPACT

This bill would not significantly impact the department’s costs.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 327 Effective for tax years beginning on or after January 1, 2009 Enactment assumed after June 1, 2009 ($ in Millions)		
2009/10	2010/11	2011/12
-$800	-$550	-$550

<u>Revenue Discussion</u>

The revenue impact of this bill would be due to the reduction in minimum tax from $800 to $100. The revenue loss is estimated separately for C and S corporations, LLCs, LPs, and LLPs.

First, the revenue loss due to C and S corporations, including bank and financials, is estimated using a department model that uses 2006 corporate tax return sample data. For each corporation, tax liabilities under the current and proposed laws were simulated, taking into account the corporation's taxable income, number of subsidiaries, current and proposed minimum franchise taxes, and newly enacted tax law that limits all business credit use to 50% of tax for tax year 2009, suspend NOL for 2009, sharing tax credits for tax years beginning 2010, and elective single sales factor for all corporations for tax year beginning 2011. The corporation must pay the larger of the computed income tax or the minimum franchise tax. The results from this simulation were expanded to the corporate population of 684,363 in 2006. Using a 2% corporate profits growth rate, the estimated revenue losses are $325 million, $344 million, $332 million, $339 million and $346 million, respectively, for tax years 2009, 2010, 2011, 2012 and 2013.

Second, because LLCs, LPs, and LLPs are not subject to the corporate income tax, and instead pay the minimum franchise tax, the revenue loss attributable to these business entities would be estimated by multiplying the number of those entities by the amount of the tax reduction, $700 ($700 = $800 current MFT - $100 proposed MFT). The revenue losses for the 2006 tax year are approximately $135 million for LLCs (192,753 x $700), $45 million for LPs (64,877 x $700), and $3 million for LLPs (4,756 x $700). Using a 2% corporate profit growth rate, the estimated revenue losses from LLCs, LPs, and LPPs are $195 million, $199 million, $203 million, $207 million and $211 million for 2009, 2010, 2011, 2012, and 2013, respectively.

Finally, the total estimated revenue losses for C and S corporations, LLCs, LPs, and LLPs are $520 million ($325 million + $195 million), $543 million ($344 million + $199 million), $535 million ($332 million + $203 million), $546 million ($339 million + $207 million), and $557 million ($346 million + $211 million), respectively, for tax years 2009, 2010, 2011, 2012, and 2013. Taxable year estimates have been converted to fiscal year estimates and rounded to the nearest $50 million in the table above.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 327
As Introduced February 18, 2009

AMENDMENT 1

On page 3, strike lines 8-40, and on page 4, strike lines "1-17."